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THE GST AND THE PROVINCES:
STATE OF NEGOTIATIONS

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Economics Division

15 August 1991
Revised 11 April 1994



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Available in Canada through
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or by mail from
Canada Communication Group -- Publishing
Ottawa, Canada K1A 0S9

Catalogue No. YM32-1/91-4-1994-04E
ISBN 0-660-15713-6

N.B. Any substantive changes in this publication which have been made since the preceding issue are indicated in **bold print**.

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THE GST AND THE PROVINCES: STATE OF NEGOTIATIONS

ISSUE DEFINITION

The possibility that provincial sales taxes will be harmonized with the federal goods and services tax (GST) introduced on 1 January 1990 is remote. Events in Saskatchewan and Quebec have radically altered the dynamic of the debate.

In early 1991, the provinces seemed to be losing their reluctance to harmonize their taxes with the GST. After Quebec and Saskatchewan signed agreements, some other provinces decided that the idea had its advantages, and began to send out sporadic signals that they were perhaps on the point of concluding agreements with Ottawa similar to those of Saskatchewan and Quebec.

Once the GST came into force, the provinces gradually seemed to drop the arguments on which they had based their opposition. For a long time, however, they had accused the federal government of interfering in consumption taxes, an area that they considered their exclusive jurisdiction. It was therefore logical for them not to move too quickly towards sales tax harmonization, given the political costs of introducing a tax that was so unpopular with the electorate.

There were, however, signs of a change in attitude; it seemed the provinces would have no choice but to join in harmonization if they wished to avoid endangering the relative effectiveness and competitiveness of their businesses or the tax treatment of capital. It was tempting to believe that the provinces that had not yet harmonized their sales tax with the GST would respond to pressure and fall into line.

In 1990, Whalley and Fretz wrote:

The coexistence of provincial retail sales taxes and a dual federal-provincial GST system yields an extremely cumbersome indirect

tax system. In the long run, it may not be viable, and pressure on non-participating provinces to join the joint federal-provincial system on grounds of simplification are likely to grow.

After believing that harmonization was on the way, Ottawa suddenly found the climate deteriorating. By the end of the summer of 1991, it was increasingly obvious that the chances for harmonizing provincial and federal sales taxes in the near future had become very slim. At this point, Saskatchewan announced that it would not be harmonizing its tax system with that of the federal government.

This review discusses the agreements designed to bring about possible harmonization of provincial sales taxes with the federal GST. Contrary to what some observers thought, it may well be that a good number of provinces will continue to oppose the federal initiative for a long time. Predictably, we have seen major reversals in the position of provincial governments that had committed themselves to harmonization. **Until very recently, a number of observers believed that the resisting provinces would continue to oppose harmonization vigorously for quite some time. Since the election of the new federal government, however, there have been a number of indications that the federal and provincial governments will be harmonizing their tax bases, including the GST and provincial sales taxes. On 21 December 1993, at the end of the First Ministers' Conference, participants said they had agreed to discuss harmonization, areas of overlap in the tax system, and even reallocating areas of taxation.**

BACKGROUND AND ANALYSIS

A. Provincial Attitudes to Harmonization

1. Historical Opposition

Even though negotiations were to have resumed after the tabling of the federal budget, the then Minister of Finance, Michael Wilson, announced on 24 April 1989, that the federal government would unilaterally establish a goods and services tax, a multi-stage value-added sales tax. The negotiations with the provincial governments about a national sales tax, that is, a tax with a uniform federal rate and variable provincial rates applied to a common

base, were interrupted for the time being. The federal government stated that the provinces did not appreciate the urgency of the undertaking.

The provinces fell back on constitutional and fiscal arguments to oppose what they believed to be a federal *coup de force*. The Government of Quebec, for instance, immediately denounced the federal decision as unconstitutional, maintaining that it represented flagrant interference in a field of taxation traditionally reserved for the provinces.

Observers believed the provinces could not use this argument for long. According to the interpretation usually given to subsection 91(3) of the *Constitution Act, 1867*, the federal government would seem to have unlimited powers of taxation. Even if a method of taxation duplicates that of the provinces, federal authorities may use it, since there is no legal constraint in this regard in the Constitution.

In opposing Ottawa's action, the provinces also maintained that a multi-stage tax would have negative repercussions on their budgetary situation. In their view, the impact would be felt in the following areas, among others: provincial sales tax revenue (elimination of the federal sales tax on manufacturing would have the effect of reducing the size of the provinces' tax base); provincial expenditures (because of the impact of the GST on public sector organizations such as hospitals, municipalities and schools, colleges and universities); and fiscal reciprocity agreements between the federal government and the provinces.

The provinces quickly found themselves facing a dilemma: would they play the political game of opposing the federal initiative (because of the political danger of this course of action and its fiscal effects) or would they profit from the economic benefits of harmonizing their sales tax with the GST.

2. Economic Benefits of Harmonization

In terms of economic efficiency and administrative simplicity, it was clearly advantageous for the provinces to harmonize their provincial sales tax with the federal tax. They were aware that replacing the old federal sales tax with a multi-stage sales tax would make their taxation system more neutral, since inputs would not be unduly taxed and the tax base would be broader. Everyone agreed that such a taxation system would increase investment, because of the reduced cost of capital property, and would make businesses more competitive in foreign

markets (because of the reduced costs of Canadian exports) and even in the domestic market (since domestic production would be taxed on an equitable basis with imports). In addition, the provinces knew that complete harmonization of the provincial sales tax with the federal GST would substantially reduce the cost to business of applying and administering the tax. The administration of two taxes, using two distinct methods of calculation, greatly adds to a firm's administrative and accounting costs. The federal government is still offering to collect provincial sales taxes at border crossings, once the provinces have begun harmonizing their tax base with that of the federal government. In terms of cross-border shopping, this could be a major source of revenue for the provinces. They would gain revenue from taxes on services, an industrial sector whose economic importance is steadily increasing. Despite all these economic advantages, however, the provinces refuse to go along with the federal government.

The idea of unifying the two taxes is not new. In 1966, the Royal Commission on Taxation (the Carter Commission) recommended a joint retail sales tax with the provinces (thus a form of national sales tax) with a view to replacing the federal manufacturers' tax. The provinces would have been responsible for collecting the tax. The Commission was of the view that it would be good for the provinces to assume almost complete responsibility for one of the major sources of tax revenue. It therefore recommended:

that the federal government seek to reach agreement with the provinces whereby they would give it more room in the field of direct taxation in exchange for greater room in the field of indirect taxation.

The idea has been reiterated by Irene Ip and Jack Mintz, who suggest that the federal government give up its jurisdiction over sales taxes and excise taxes (tobacco, alcohol and fuel) in exchange for a greater share of individual income taxes and exclusive control of corporate taxes. They also suggest that the federal government should simply withdraw from the areas of health, education and social assistance if an agreement with the provinces is not reached.

During negotiations with the provinces on a national sales tax, there was nothing to suggest that Ottawa was prepared to offer the provinces such a compromise on taxation powers in order for its initiative to be more favourably received. Probably because of the

pressure of time, the federal government decided to act unilaterally by introducing a multi-stage federal sales tax parallel to that of the provinces. In fact, even if Ottawa had decided to negotiate longer with the provinces, the chances of reaching agreement would have been rather unlikely.

3. The Political Price

There is little doubt that the provinces perceived the introduction of the GST as too politically damaging. By entrusting the burden of administering a joint tax to the provinces, Ottawa would have managed to avoid blame and the provinces would have had to bear, almost alone, the political burden associated with introduction of the federal GST and the broader provincial tax bases. In addition to the negative political fallout that a federal-provincial agreement would have had on the provinces, the other major obstacle to an agreement has been the harmonization of the tax bases. It is, in fact, impossible to harmonize tax regimes completely in a political system where the governments have overlapping powers of taxation, with each level of government defining its tax base to suit itself. Quebec's experience is a clear example of this: the province was unable to harmonize its sales tax with the GST. If a number of provinces modified their respective sales taxes to conform to the GST, the issue of the tax treatment of interprovincial trade would have to be resolved. A solution would also have to be found for transactions between provinces. It would have to be decided whether the tax base should be established according to goods' destination or according to their origin; rates and the tax base would have to be defined in the same way. There are no clear solutions for any of these issues. For these reasons, observers felt it was logical to believe that the provinces would not participate in the federal project.

The situation changed sooner than expected; as we noted at the outset, two provinces had agreed to harmonize their provincial sales tax with the GST, and there were signs that a similar arrangement with several other provinces might be imminent. Following the lead of Quebec and Saskatchewan, Prince Edward Island had announced that it intended to reach an agreement with Ottawa shortly, and a few weeks before the GST took effect Newfoundland had announced that it would broaden its tax base to make it more consistent with that of the GST.

However, after the end of August 1991, the situation was not as rosy as the federal government had hoped. Most provinces were still opposed to harmonization and observers agreed that the situation would probably persist as long as other major provinces (such as Ontario and British Columbia) did not follow the route taken by Quebec and Saskatchewan.

The situation then deteriorated rapidly. In October 1991, following the election in Saskatchewan of an NDP government that had already announced it would not harmonize the province's sales tax with the GST, the federal government had to accept that it had lost an ally in its quest for harmonization. Quebec thus became the only province whose sales tax is harmonized with the GST. However, the federal government lost ground there too, when Quebec delayed implementation of the second phase of its memorandum of agreement with Ottawa. The strong position Ottawa had gained then eroded very rapidly. Canada has never been so far from full harmonization of provincial sales taxes with the GST, in spite of the many valid arguments in favour of it.

B. Why Some Provinces Have Harmonized Their Sales Tax with the GST

When Quebec and Saskatchewan announced (in August 1990 and February 1991 respectively) that they would harmonize their respective sales taxes with the GST, these announcements came as a surprise, given the public positions of these two governments only few months earlier. It was even more surprising in the case of Quebec but it was Saskatchewan that reversed its decision, in October 1991.

The two provinces' decision to harmonize can probably be explained in two ways. First, they recognized that a multi-stage tax can produce major economic benefits, including the increased efficiency and lower administrative costs already noted. Economic logic therefore won out over political consequences. These provinces had to admit that the GST produces additional revenues that can be substantial and are particularly welcome at a time when provincial budgets are running deficits. Both provinces realized, for instance, that a broader tax base, resulting from conformity with the GST, could be beneficial. In addition, the provinces had always been aware that they were losing a major source of revenue at points of entry to Canada, where customs officials were administering only the duties, customs tariffs and excise taxes of the

federal government. When the two provinces agreed to harmonize their provincial tax with the GST, Revenue Canada - Customs and Excise agreed to collect, on their behalf, provincial sales taxes on goods crossing the border, and agreements to this effect were signed. The other provincial governments would have liked Revenue Canada to do the same for them. The federal Minister of Revenue made it clear that he would not collect provincial sales tax at the border on behalf of governments that refused harmonization, though he would provide them with a list of citizens who had paid the GST on imported goods. The Department has since softened its position. In the spring of 1993, the Department of Finance announced that the government would collect sales taxes for those provinces that harmonized their tax base with the GST on goods alone (excluding clothes, shoes and books). Since 1 July 1993, two other provinces have arranged to have their taxes collected by customs officials. In September, the Department of Finance is to begin similar negotiations with at least two other provinces.

The other reason why Quebec and, for a time, Saskatchewan changed their position was political. As we shall now see, some provinces have included the GST in the tax base. This "cascade" (or double taxation) effect has been politically difficult to defend to consumers and businesses already hostile to the GST and its very broad tax base. The provinces have thus been placed in an unenviable position. Although the provinces may plead that they had no alternative, given the loss of revenue they experienced after replacement of the federal sales tax by the GST, consumers and businesses working in the provinces that "tax the GST" are unhappy.

Under the former taxation system, provincial sales taxes were applied to prices that included the federal sales tax. Since the coming into force of the GST, therefore, the provincial revenues have diminished, because the GST is excluded from the provincial tax base. The reduction in tax from 13.5% to 7% has produced shortfalls for provincial governments because of the reduction in the tax base that came about if the average effective taxation rate of goods and services was greater than 7/107 and if overall demand lacked elasticity with regard to prices. In order to compensate for this shortfall, the provinces have perhaps had to increase the rate of their sales tax, or broaden the tax base, or impose the provincial tax on the GST.

Some provinces have been obliged to adopt this double taxation policy so as not to compromise the size of their revenues. Against their will, and while opposing the federal tax,

these provinces have placed themselves in the politically unenviable position of having to defend the double taxation effect of two consumption taxes applied one upon the other. The other provinces, those that have refused to tax the GST, may face a shortfall because of their smaller tax base.

Five of the ten provinces have decided to include the GST in the tax base (see Table 1); the four Atlantic provinces and Quebec impose their provincial sales tax on retail prices that include the federal GST. None of the provinces west of Quebec does so.

For instance, Ontario under the NDP government decided to reverse the position of the previous Liberal government, which had said it would impose a provincial sales tax reduced by one per cent on a tax base that would include the GST. Most Ontario consumers do not realize, however, that the effective tax rate is now higher than it would then have been. By maintaining the 8% provincial sales tax and by excluding the GST from the tax base, the Government of Ontario is imposing an effective rate of 15%. If the Liberal position had been kept, the effective rate of taxation today would be approximately 14.49%.

Table 1
THE GST AND THE PROVINCES
(AS OF 6 OCTOBER 1993)

Province	General	Accommoda- tion/ Housing	Alcohol/ Spirits	GST Included in the Tax Base	Overall Implicit Taxation Rate
Newfoundland	12	12	12	yes	19.84
Prince Edward Island	10	10	10	yes	17.70
Nova Scotia	11	11	11	yes	18.77
New Brunswick	11	11	11	yes	18.77
Quebec	0/4/7/8	n/a	variable	yes	0/7/11.28/15.56
Ontario	8	5	10/12	no	15
Manitoba	7	7	7/12	no	14
Saskatchewan	7	7	variable	no	14
Alberta	n/a	5	n/a	no	7
British Columbia	6	8/10	10	no	13

It should be borne in mind that the provinces that impose the provincial tax on the GST (including Newfoundland, Nova Scotia and Quebec) are continuing to do exactly what

all the provinces did under the former federal sales tax system. These provinces are not only able to recover the provincial revenue lost through the GST, but have even collected additional revenue. This is because, under the former system, the provinces issued rebates to businesses for the portion of the provincial tax that was applied to the federal sales tax, and which had been included in the retail price. Several provinces had a *pro rata* system of rebates for the portion of the provincial sales tax imposed on the federal sales tax. At present, the provinces do not, however, intend to issue rebates to businesses for the portion of the provincial tax calculated on a price that includes the multi-stage tax.

The most optimistic scenario from the point of view of the federal government is for several recalcitrant provinces to harmonize their sales tax with the GST because of the economic and monetary advantages of doing so and to avoid paying the political price of taxing the tax. According to this scenario, as the number of provinces harmonizing their provincial sales tax with the GST increases, the pressure on those still resisting will be all the greater, particularly if Ontario eventually reaches an agreement with the federal government. The resisting provinces would simply have no choice but to conform. The most pessimistic scenario is for the provinces to maintain their opposition for a long time; according to telephone conversations with persons in the capitals of the nine provinces with a provincial sales tax, this last scenario appears to be the more likely. As we shall now see, matters will probably not improve for the federal government over the next several months.

C. Current Position of the Provinces

Today only Quebec has harmonized its provincial sales tax with the GST. Following the election of 21 October 1991, Saskatchewan announced that it would not be going ahead. The other provinces have still not concluded agreements on harmonization; indeed Prince Edward Island has rescinded the decision to harmonize announced in its last budget. Other provinces have taken the matter to the courts, alleging that the GST is unconstitutional. Lastly, several provinces are in a holding pattern and are studying the situation before taking a decision. Given the current climate, it seems more and more likely that harmonization will not take place. This section describes the position of each province with respect to harmonization of taxes.

1. Quebec

a. Memorandum of Understanding between the Two Governments

On 30 August 1990, the Government of Quebec and the federal government announced the signing of an agreement under which the federal government transferred administration of the GST in full to Quebec. Until January 1992, Quebec in turn agreed to harmonize the tax base of its provincial sales tax with the federal government's multi-stage sales tax.

However, as noted above, Quebec had refused for a long time to participate in the GST. This explains why the announcement was made casually in the full heat of the emergency debate in the National Assembly on the Kahnawake crisis and the creation of a larger parliamentary committee on the constitutional future of Quebec. The decision to align the provincial sales tax with Ottawa's was particularly surprising in light of the events that had taken place earlier that summer with respect to the Meech Lake Accord.

By admitting that it had become necessary to replace the federal sales tax on manufacturing (which was outdated in many respects) with a more modern sales tax, and by agreeing to harmonize the two taxation systems, Quebec placed its economy in a better position to compete with other provinces and other countries. By decreasing the cost of inputs and capital, it made the province's industries more competitive. In its 1991 Technical Document, the Government of Quebec estimated that adoption of this fiscal policy would create a growth of 0.5% in the province's GDP. Similarly, by expanding the tax base and lowering the sales tax rate, it was thought that the tax policy would not have a major impact on consumer behaviour.

This agreement was also expected to make administration of the two taxes more efficient and less costly both for business and government. Retailers would finally enjoy more uniform tax rules and adopt a single accounting system and centralized administration. Small and medium-size businesses in particular expected to save time and money by collecting, on behalf of the governments, better harmonized taxes that would henceforth be applied to nearly identical tax bases. The real situation, however, was not so simple. Administering the two taxes proved to be extremely complicated because of the different rules. Furthermore, according

to a survey by the Canadian Federation of Independent Business, changes to the Quebec sales tax cost Quebec's economy \$1.3 billion in one year. Even Quebec's Minister of Finance, in his 20 May 1993 budget speech, said that certain advantages expected in terms of simplicity had been slow to materialize. The governments had predicted that they would be able to reduce by 500 the number of employees needed to administer the two taxes; the result has turned out to be quite different. On 1 December 1992, Quebec admitted that the Quebec sales tax and its administration by Quebec's Ministry of Finance had incurred expenditures of \$100 million and required an additional 1,400 public servants.

The federal government was delighted with Quebec's decision, which it hoped would have a ripple effect and encourage the other provinces to follow suit. The federal government saw an opportunity to ensure that standard tax rules were applied in a major region of Canada and to demonstrate that it was possible to achieve a multi-stage federal tax harmonized with all other provincial sales taxes. This ripple effect has yet to make itself felt, however.

Harmonization of Quebec's provincial tax with the GST was accomplished in two steps. On 1 January 1991, the provincial tax base was harmonized with that of the GST with respect to personal (movable) goods. By 1 January 1992, the base was supposed to be extended to include services and real (immovable) property. The decision to delay implementation of this second phase (until 1 July 1992) was announced on 24 October 1991 by the provincial government, which justified its decision on the grounds that Quebec's economic position was precarious and extension of the provincial sales tax to a larger tax base might be harmful.

As of 1 July 1992, Quebec administers the GST collected within that province. In the meantime, the federal government helped Quebec assume these new administrative functions by handing over the infrastructure (facilities and equipment) and will also contribute \$20 million over three years towards start-up costs. In addition, federal GST staff were offered comparable jobs in the provincial public service. Lastly, the two governments will share equally the expenses of administering the sales tax programs.

It should be noted that under this agreement the Government of Quebec abandons, as it were, a portion of its legislative powers, since Ottawa has sole responsibility for policy development. Thus, tax interpretations, the structure of the tax base (i.e., what is included or

excluded), the design of forms and preparation of information bulletins, for instance, are under the exclusive control of the federal government and the provincial government will abide by the standards set by Ottawa.

Quebec is responsible only for administering the two taxes. It disseminates information, oversees the registration of businesses, performs audits and deposits revenues in the accounts of the Government of Canada. One special point is that Quebec is responsible for administering the tax with businesses in French only. This situation has come about because the *Charter of the French Language* stipulates that written communication with corporations established in Quebec is to be in French only. When Quebec is thus unable to fulfil its duties in accordance with the *Official Languages Act*, Anglophone businesses operating in Quebec must use the services of the federal government.

b. New Principles of Application

With the exception of a few special items (such as books, financial services and insurance), the Quebec sales tax base with respect to the provision of goods and services to consumers is identical to that of the GST. Thus, goods and services exempted from the GST, as well as those that have been detaxed, will normally be the same in both the Quebec sales tax system and that of the GST.

The Quebec tax is not a multi-stage tax like the GST. In this respect it differs significantly from the GST system with respect to goods and services provided to businesses. Thus, the Quebec sales tax does not apply to the provision of movable goods and services intended for resale or to goods intended to be used to make another product. With the exception of construction materials, the sales tax does not apply to production inputs. For instance, nails used to fasten asphalt shingles to a roof of a house are taxable (but reimbursed under the tax rebates on inputs), whereas accounting, computer and office furniture services used by the same construction firm are non-taxable.

These suppliers are non-taxable and exempt from provincial taxes upon presentation of a certificate. This was prompted by constitutional limitations (subsections 92(2) and 92(9) of the *Constitution Act*). Contrary to Saskatchewan's position, and in spite of legal opinions issued by Ottawa, Quebec believed it was unconstitutional for a province to impose a

sales tax at various levels of production and that it lacked the authority to use indirect taxation (that is, a tax that imposes a burden on someone other than the person being directly taxed). The provincial government therefore chose to be cautious and adopted the opposite position to that of Saskatchewan and Ottawa. In Quebec, the new provincial tax is considered legally incontestable.

In order to simplify the tax system, the government now suggests that the Quebec sales tax be collected in the same way as the GST - at every stage in the production process. The budget speech of 20 May 1993 reads:

[...] steps are currently being taken to have this issue (Quebec's right to collect the Quebec sales tax at all stages of the production process) resolved by the Supreme Court. Once a judgment has been rendered, and if it is favourable to harmonization, we will proceed as quickly as possible with the last phase of GST and Quebec sales tax harmonization.

The Government of Quebec feels that it will then have met its original objectives.

On 1 January 1991, the Quebec sales tax was lowered from 9% to 8%. As of 1 July 1992, the tax applied to all personal property, real estate and services in Quebec, as does the GST. The original plan anticipated that, with a broader tax base in 1992, the tax rate would be reduced to 7%. However, in the budget brought down on 2 May 1991, the Minister of Finance announced that the rate would stay at 8%. On 14 May 1992, he announced that real estate and services would be taxed at a rate of 4%.

This rate flexibility is offset by a 2% tax rate increase on corporate income from assets. Next, contrary to expectations, businesses are not refunded the tax on fuel, electricity, natural gas, heating oil, telephone and telecommunications services, vehicle purchase or expenditures for meals and entertainment. The absence of the refunded provincial sales tax on certain items cost businesses \$422 million in 1992-93, and will cost \$650 million in 1993-94 and \$689 million in 1994-95. The government claims that businesses will benefit from refunds of as much as 80% of provincial sales tax paid, and the reform will nonetheless make possible a net reduction in business production costs of some \$850 million.

In five years, Quebec's consumption tax revenues have gone up by \$2 billion, or 50%. In 1987-88, Quebec collected \$4 billion from its sales tax, while results for 1991-92

indicate that gross revenues from the new provincial sales tax totalled \$6.158 billion. For fiscal year 1992-93, these revenues should total \$6.026 billion, and for fiscal year 1993-94, \$5.820 billion.

2. Saskatchewan

In its budget of 20 February 1991, the Government of Saskatchewan announced that the province would harmonize its sales tax with the GST in two steps. On 1 April 1991, it broadened its tax base to include most of the goods covered by the GST. Full harmonization of the system, including the taxation of services and real estate and establishment of a more centralized administration of the two tax systems, was supposed to come into effect on 1 January 1992.

A provincial election held on 21 October 1991 was won by the NDP, which had made rejection of the proposed sales tax harmonization a plank in its campaign platform. On 22 October the new government withdrew from the list of taxable goods all products that had been added on 1 April 1991, thus restoring the situation that had existed before that date.

Even with a so-called "harmonized" system, the tax bases and terms of their application in Quebec, Saskatchewan and Ottawa would not have been identical. Unlike Quebec, Saskatchewan had no misgivings about using indirect taxation, and the new provincial sales tax would have been a multi-stage tax. The province and Ottawa had agreed that Saskatchewan was acting in an entirely legal manner and within the limits set out in the Constitution.

The administrative agreement Ottawa signed with Saskatchewan was not identical to the one it had signed with Quebec six months earlier. Harmonization would, of course, have meant a common tax base (with some special provincial characteristics such as treatment of fertilizers) and a more centralized administration of the two tax systems for which both levels of government shared the costs equally. However, Ottawa and the province were supposed to administer both taxes jointly. The agreement was rather ambiguous on this particular matter. One possible interpretation was that Ottawa would supervise the province. Moreover, the provincial government had announced its intention to create a paragovernmental organization responsible for collecting both taxes. This method of collection could have been in operation by 1 January 1994. In the meantime, the federal government was to contribute \$7.5 million to help with start-up costs.

The decision to harmonize the provincial sales tax and the GST had been expected for some time, since the GST Advisory Committee had recommended this step a few months earlier. The province realized that it could thus reap several economic benefits. As a result, the government was predicting increased competitive capacity for businesses operating in Saskatchewan, increased horizontal and vertical equity of the taxation system, simplified administration of the two taxes for governments as well as for businesses and protection of the province's farmers through a more generous funding of programs such as GRIP and NISA. The province foresaw an increase of only 1.6% in the growth of the GDP and the creation of 5,000 jobs, thanks to increased business productivity in Saskatchewan.

The new harmonized sales tax was expected to produce gross revenues of \$140.2 million in 1991-92 and \$185 million in 1992-93. If, for instance, one includes tax credits to counter the negative impact of the new sales tax, the surtax applied to high incomes, and increased tobacco and corporate taxes, the province might have anticipated additional net revenues of \$126.3 million in 1991-92 and \$181.1 million in subsequent years.

It should be noted that the increase in corporate taxes had been greeted angrily by the province's business community. The support the province anticipated from this sector never came. Despite the promises with respect to GRIP and NISA, farmers also withheld their support. Though the NDP government's decision not to proceed with harmonization may be costly, it is not surprising.

3. Prince Edward Island

In its budget of 9 April 1991, Prince Edward Island announced that it would harmonize its sales tax with the GST on 1 January 1992. On 8 August 1991, however, the government reversed its position.

For four months the situation had been ambiguous, even before the Minister of Finance finally reversed his decision; in fact, there was every reason to believe, according to a confidential source in the provincial capital, that harmonization would not have taken place for four or five years. In the meantime, the Minister had also announced that other studies were necessary. Some politicians felt it would be politically costly, for instance, to place a tax of 10% on what was already the most expensive electricity in the country.

4. Alberta, Ontario and British Columbia

These three provinces have brought legal action against the federal government. They allege that it has exceeded its constitutional authority by operating in an area of taxation reserved for the provinces and should financially compensate businesses that collect the GST on its behalf. In June 1992, the Supreme Court confirmed that the GST is constitutional and that businesses do not have to be compensated. Negotiations in Ontario and British Columbia are at a standstill. The federal Minister of Revenue is refusing to allow border stations to collect taxes on behalf of the provinces until the provinces have harmonized their taxes with the GST. Even so, it appears from the budget of 19 May 1993 that Ontario will continue to resist for a long time, contradictory signals from that province notwithstanding. In February 1992, Ontario committed itself to serious consideration of the federal proposal and on 10 April 1992, Ontario's Fair Tax Commission suggested that Ontario's provincial sales tax be harmonized with the GST; however, the following day Bob Rae rejected this suggestion. A number of observers believed that Quebec's decision to harmonize its sales tax with the GST would force the Ontario government to do the same. Concurrence between the two provincial tax systems has never been achieved because the Quebec sales tax proved so costly for the Quebec government and for businesses in particular.

In its final report published in December 1993, the Fair Tax Commission reiterated its position and once again proposed that the GST and the provincial sales tax be harmonized. It even suggested that the government broaden the tax base by taxing store-bought prepared foods (such as frozen dinners) and financial services, for example.

5. Manitoba

In Winnipeg, negotiations are also at a standstill. Even though the provincial government officially disliked harmonization, the door was not completely closed. However, with the election of an NDP government in Saskatchewan, the pressure on Manitoba has undoubtedly eased considerably. In February 1992, the province was suggesting that it might well conclude a harmonization agreement with Ottawa. The agreement so far entails partial harmonization of the taxation base and does not cover clothes, books or shoes. Customs officials have collected sales tax for the Manitoba government since 1 July 1993.

It is interesting to recall that though Manitoba supported the federal government in its attempt to reach an agreement with the provinces on a national sales tax, it has never publicly supported the GST.

6. New Brunswick

In New Brunswick the official response to harmonization is still negative. The province is refusing to expand its taxation base to make it conform with that of the GST. However, the province did agree to amend the part of its taxation base that involves goods, so as to harmonize it partially with the GST. Under this agreement with Ottawa, Revenue Canada has collected the New Brunswick sales tax at the border since 1 July 1993. According to sources in Fredericton, no negotiations are underway at the moment.

7. Nova Scotia

The provincial government announced on 22 August 1991 that the provincial sales tax would not be harmonized with the GST. On 13 February 1992, however, only a few days after having called the GST unacceptable, the Premier said that the province would study the merits of harmonization. The new government in Nova Scotia, elected in 1993, has made no comment on this issue. The government's official position is, therefore, the same as it was in August 1991.

8. Newfoundland

The Government of Newfoundland announced on 19 December 1990 that its tax base would be amended to correspond more closely to that of the GST. The federal government should not interpret this as an extraordinary sign of encouragement since Newfoundland has adopted a common taxation approach only to basic food products, prescription drugs and medical equipment and has thus expanded its taxation base. In St. John's, it is predicted that this new tax base will produce only \$3 million in additional revenue. However, no one is denying the possibility of further negotiations.

Newfoundland's problem is that the tax base is already very broad. One-third of the province's sales tax revenue comes from taxes on business inputs. Total harmonization of the province's taxation rules with those of Ottawa has proved difficult because the province has

so little room to manoeuvre. The provincial government held a public debate on tax reform and in April 1991 published a document to serve as the basis for this. In March 1992, Newfoundland's Minister of Finance said that the province was still considering the possibility of harmonizing the two taxes. In August 1993, sources in St. John's implied that plans for harmonizing the provincial tax with the GST would soon be submitted to Cabinet. Harmonization would be complete (covering electricity and gasoline) and would involve reducing the current 12% sales tax and increasing corporate taxes to compensate for the shortfall created by tax rebates on inputs.

9. General Comments

In his economic and fiscal statement of 2 December 1992, the federal Minister of Finance stated:

Sales tax harmonization represents a major opportunity to reduce the burden of government on the private sector, and particularly on small business. I urge my provincial colleagues to join me in a renewed effort to align our sales taxes not only with each other but with the reality of the tough, competitive world in which our business people must operate.

The current situation does not look favourable for the federal government but the signals are contradictory. To date only Quebec has agreed to follow the federal program and we have seen that harmonization of the two taxes has failed to simplify their administration and collection by businesses on behalf of the two levels of government. The existence of four tax rates (0%, 4%, 7% and 8%) further complicates the administration of the two taxes.

Pressure in favour of harmonization is not as strong as some hoped two years ago. This situation will likely continue, especially with the Conservatives in power in Ottawa and NDP governments in Ontario, Saskatchewan and British Columbia. In its pre-electoral campaign in the fall of 1993, the Liberal Party of Canada pledged to eliminate the GST and replace it with a sales tax that would be simple to administer and would require greater harmonization between the provinces and Ottawa. The Liberals' proposal represents a return to the principle of a national sales tax. It should be noted that, before imposition of the GST, this was the type of tax that the Conservative government had wanted to adopt; it had to give up this idea in 1989

when it could not reach agreement with the provinces, as both levels of government refused to change their position. **The House of Commons Standing Committee on Finance is now looking at options for replacing the GST and at how to harmonize the various expenditure tax regimes.** Quebec may well continue to be the only province whose direct taxation is harmonized with the GST. Until recently, it seemed Quebec would continue to be the only province whose direct taxation was harmonized with the GST. However, the spirit of co-operation that has arisen between Ottawa and the provinces since the election of the new federal government may well encourage some provinces to reconsider the allocation of areas of taxation and to harmonize their sales taxes with the GST. In fact, harmonization may well involve far more than just the GST, and lead to an in-depth reform of all Canada's taxation systems.

CHRONOLOGY

- 18 June 1987 - White paper on tax reform.
- 24 April 1989 - Negotiations between Ottawa and the provinces on harmonization of the provincial sales taxes and the future federal sales tax were broken off. The Government of Canada dropped the idea of a national sales tax and decided to act unilaterally.
- 8 August 1989 - Technical document on the GST.
- Winter 1990 - Adoption of Bill C-62.
- 30 August 1990 - Quebec announced its intention to harmonize its sales tax with the GST.
- Fall 1990 - Senate debate.
- 14 December 1990 - The Quebec National Assembly adopted amendments to the *Loi concernant l'impôt sur la vente au détail* to include provisions applicable to Quebec as of 1 January 1991.
- 19 December 1990 - Newfoundland amended its taxation base.
- 21 December 1990 - Reciprocal taxation agreement between Ottawa and Quebec on implementation methods.

- 1 January 1991 - The GST came into effect in Canada, as did the first phase of the new harmonized provincial sales tax in Quebec.
- 20 February 1991 - Saskatchewan announced that it would harmonize its provincial sales tax with the GST.
- April 1991 - First phase of harmonization of the Saskatchewan sales tax with the GST.
- 9 April 1991 - The Prince Edward Island budget announced that the provincial sales tax would be harmonized with the GST.
- 8 August 1991 - The government of Prince Edward Island announced that the harmonization of the provincial sales tax with the GST would not take place.
- Fall 1991 - The bills necessary for the introduction of a complete consumer tax reform were to be presented in the Quebec National Assembly and in the Saskatchewan Legislative Assembly.
- 22 August 1991 - The government of Nova Scotia announced that it would not be harmonizing the GST and its provincial sales tax.
- 21 October 1991 - An NDP government was elected in Saskatchewan.
- 22 October 1991 - Return to the tax treatment situation that existed in Saskatchewan before 1 April 1991.
- 24 October 1991 - Quebec delayed introduction of its tax on services for six months.
- 14 May 1991 - The government of Quebec announced that the provincial sales tax would also apply to services, at a rate of 4%.
- 1 July 1992 - The second stage of sales tax reform came into effect in Quebec.
- 1 July 1993 - After New Brunswick and Manitoba had partially harmonized their taxation base with the GST, Revenue Canada began to collect provincial sales taxes for these provinces at the border.
- 1 December 1993 - In its final report, Ontario's Fair Tax Commission proposed that the GST and the provincial sales tax be harmonized, and that the provincial tax base be broadened.

February 1994 - The House of Commons Standing Committee on Finance began its study of the GST.

1 June 1994 - This is the expected date for the tabling of the Finance Committee's report on the GST.

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